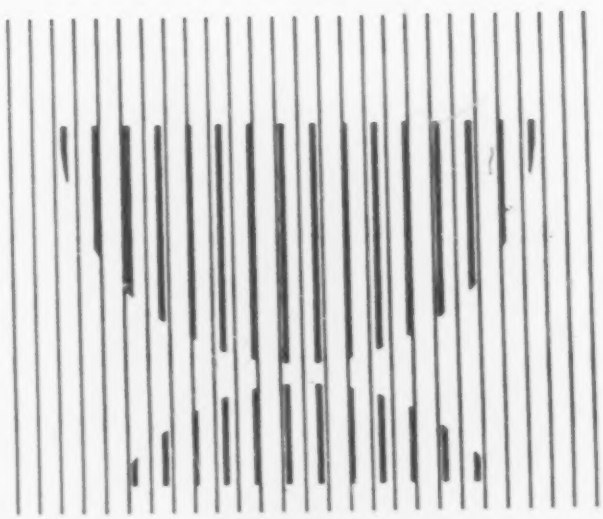
CBO STAFF MEMORANDUM

AN EXPLANATION OF THE BUDGETARY CHANGES
UNDER CREDIT REFORM

April 1991



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This Congressional Budget Office Staff Memorandum describes the changes in federal credit programs as a result of credit reform accounting. It was prepared by Danila Girerd of the Budget Analysis Division under the supervision of Marvin Phaup. Questions regarding the memorandum should be addressed to Danila Girerd at (202) 226-2838.

HIGHLIGHTS OF CREDIT REFORM ACCOUNTING

After more than 20 years of discussing the inadequacies of the accounting system for credit activity in the federal budget, the Congress and the Administration recently agreed to change the existing budgetary treatment of credit programs. The Federal Credit Reform Act of 1990 (FCRA), which is part of the Budget Enforcement Act (BEA), requires the federal budget, beginning in fiscal year 1992, to account for credit programs so that their costs can be more easily compared with the costs of other federal spending.

Federal credit programs are costly to the federal government because they are intended to provide more favorable terms to targeted borrowers and certain sectors of the economy than are available from private lenders. The federal government often lends to those who have been rejected as poor credit risks and often does so at less than the Treasury's borrowing rates. Hence, most loan programs experience losses from net interest costs, delinquencies, and defaults.

The costs of a direct loan transaction can be divided into two components. The first is the subsidy component, which is the value of the cash disbursement that is not expected to be returned to the federal government from borrower payments. The second is the unsubsidized component, which

is the amount of the transaction that the government expects borrowers to repay fully over the life of the loan.

Subsidies are also inherent in some federal loan guarantees. Under a guarantee contract, the federal government usually pays a private lender when a borrower defaults. The present value of any excess of this payment over the fees collected from the borrower is the subsidy.[1] In some cases, grace periods are provided during which the federal government pays the interest for the borrower to the private lender. These payments also add to the subsidy costs.

Credit reform applies to nearly all federal direct loans and loan guarantees. A direct loan is defined as a disbursement of funds that is contracted to be repaid with or without interest. A loan guarantee is a binding agreement by the federal government to pay, in whole or in part, the principal and/or interest on loans disbursed by private lenders if the borrowers default. However, all credit or insurance activities of deposit insurance--the Pension Benefit Guarantee Corporation, the Tennessee Valley Authority, the National Insurance Development Fund, the Federal Crop Insurance Corporation, and the price support loans of the Commodity Credit Corporation--are excluded from credit reform.

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1. The present value is the current value of a claim on an amount or series of amounts of money to be paid by the government in the future.

The heart of the new credit accounting lies in identifying the subsidy costs inherent in nearly all federal credit programs and separating these from the nonsubsidized cash flows. Under the current system, which applies only through fiscal year 1991, outlays measure federal credit on a cash basis; that is, outlays for direct loans and for loan guarantees that have defaulted are recorded in the budget net of collections. Programs with large volumes of credit activity, therefore, can be reported as having small net outlays. Under credit reform beginning in fiscal year 1992, the budget will reflect the budget authority and outlays needed to cover the subsidy costs of loans and guarantees at the time they are extended to borrowers. The subsidy, as defined in the FCRA, is the "estimated long-term cost to the government of a direct loan or loan guarantee calculated on a net present value basis, excluding administrative costs."

Credit reform is intended to change the accounting system for federal spending when extending credit to individual borrowers and different sectors of the economy. Credit reform accounting will not change the types or terms of assistance currently provided to the public through federal credit. In fact, most borrowers will probably be unaware of this accounting change. Borrowers will continue to receive direct loans and loan guarantees from the same federal agencies that currently provide assistance, and agencies will administer loans and guarantees as they do now.

Nevertheless, credit reform is a significant departure from past budget practice. For that reason, this memorandum discusses in detail the changes that will result in federal credit programs under a new budgetary system.[2]

CURRENT ACCOUNTING AND CONTROL OF CREDIT PROGRAMS

The current accounting for credit programs is based on cash flows and hence does not reveal the true costs of credit activities, such as the subsidized costs over the life of the loan, at the time they are undertaken. Credit accounts include all cash flows associated with credit programs; some grant programs are commingled with the credit activity. No distinction is made between loan disbursements, repayment of principal and interest, payments for default claims, and the sale of acquired properties. All these transactions are recorded in budgetary totals as receipts or outlays of the federal government.

Current Budgetary Accounting

Despite the subsidy component in federal credit, current budgetary accounting does not reflect these subsidies at the time the costs are incurred. Initial

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2. For details on the background of credit reform see, Congressional Budget Office, *Credit Reform: Comparable Costs for Cash and Credit* (December 1989).

outlays for direct loans are currently recorded equal to a loan's disbursement minus repayments. The budgetary cost of a direct loan in the year of disbursement, therefore, is equal to a grant of the same size, even though the loan's long-term cost is less because of expected repayments of principal and interest. Repayments from direct loans are recorded in the budget as offsetting collections in the year received. Thus, depending on the pattern of disbursements and repayments, a program's net outlays may be positive or negative in a year in which the new costly lending has occurred.

Outlays for guarantees are recorded in the budget when defaults occur, which can be long after the government has committed itself to the guarantee. Therefore, under current credit accounting methods, loan guarantees usually appear to have no deficit costs in the year the commitment is made. In fact, because fees are sometimes collected, some guarantee programs actually reduce the deficit in the year of commitment. Only in the outyears, after the commitment is made, are the costs associated with loan guarantees recognized and recorded in the budget.

The current accounting system for credit, therefore, generally overstates the costs to the government of new direct loans and understates the costs of new loan guarantees. This creates a bias in favor of guarantees and against direct loans. Because of the budget's cash-basis accounting system, it has been

possible to reduce the budget deficit by substituting guarantees for direct loans even though ultimate federal losses from the two policies may be identical. Credit reform will change the current accounting method so that the costs of credit programs can be compared more accurately with one another and also with the costs of noncredit programs.

Current Budgetary Controls

All credit programs are currently subject to some form of Congressional control. Three methods are used to limit direct loans and loan guarantees: setting limits on loan volume in appropriation bills; appropriating a limited amount of budget authority for credit activity; and, for mandatory programs, setting eligibility criteria and benefit levels in legislation. However, none of these methods is closely related to measuring and controlling credit subsidies.

The majority of credit programs are subject to annual volume limits. In many cases, the legislated limits have had no real effect on actual activity. Credit programs, such loan guarantees of the Export-Import Bank and the mortgage insurance programs of the Federal Housing Administration, are usually assigned loan limits far in excess of actual borrower demand. For a few discretionary credit programs, the loan levels are only a fraction of the budget authority appropriated.

Most discretionary accounts for credit programs are revolving funds. A revolving fund is an account authorized to be credited with collections to finance a continuing cycle of activity, including lending. Revolving funds do not require an appropriation unless the fund balances and collections are insufficient to finance new activity. Most credit revolving funds have the authority to borrow directly from the Treasury when necessary. Thus, budget authority does not effectively constrain credit activity financed from revolving funds. Finally, appropriation actions do not effectively control mandatory credit programs, such as Stafford student loans and the Veterans Administration's loan programs, because their loans must be available to all eligible borrowers.

CREDIT REFORM ACCOUNTING AND CONTROL

Credit reform expands the existing information on cash flows from direct loan obligations and loan guarantees to identify the net present value of the subsidy costs of these transactions. This new procedure attempts to recognize the costs of providing credit at the time the costs are incurred. This treatment insulates budget outlays and the deficit from the effects of the government's financing of the nonsubsidized part of credit transactions. As a result, credit reform places the net costs of credit and noncredit activity on a comparable basis.

Credit Reform Accounting

Below are examples of the budgetary treatment of credit and noncredit programs under cash-basis accounting and under credit reform. The first example assumes a $100 direct loan with a $20 subsidy. The second is a $100 loan guarantee with a $20 subsidy and a $1 loan origination fee. Both loans are fully disbursed in the first year. The third example shows the accounting for a noncredit program with a cost of $20.

	Before Credit Reform		After Credit Reform	
	BA	Outlays	BA	Outlays
Direct Loan	100	100	20	20
Loan Guarantee	0	-1	20	20
Noncredit	20	20	20	20

Prior to credit reform, the direct loan transaction is recorded as budget authority and outlays of $100 in the year of disbursement.[3] The guarantee would reduce outlays by the amount of the fee collected and would require zero budget authority. The noncredit activity is recorded as $20 in budget authority and $20 in outlays. After credit reform, the budget cost for both the direct loan and the loan guarantee would be $20. For most direct loan

3. For direct loans financed from revolving funds, the budget authority recorded would be equal to net outlays from the fund for the year.

programs, credit reform will decrease outlays in the year of the disbursement; for guarantees, credit reform will increase outlays in the year of disbursement by the private lender.

Credit reform will result in the creation of five different types of accounts. The accounts are as follows:

1) the credit program account (for any credit subsidies for fiscal year 1992 and subsequent years, and for financing the costs of administering federal credit programs);

2) the noncredit account (for any noncredit activities, for example, grants that are currently included within credit accounts);

3) credit financing accounts (for financing the nonsubsidized cash flows);

4) liquidating account (for administering the repayments and defaults on credit obligations and commitments made before credit reform; and

5) receipts accounts (to collect any negative subsidies in cases where federal credit activity shows a profit).

All five of these accounts will be used in both the President's budget and the reports of the Congressional Budget Office (CBO) for all years, starting with fiscal year 1992. Four of these will be included on-budget, while one (the credit financing account) will be a nonbudgetary means of financing.

For direct loans the program account receives the subsidy appropriation of $20 and deposits these funds into the financing account. This $20 expenditure is recorded as a budget outlay. The Treasury finances the balance of the loan ($80) by borrowing from the public and lends $80, or the nonsubsidized portion of the loan, to the financing account. The financing account disburses the $100 loan to the borrower, collects the repayments, and repays the Treasury interest and principal.

For loan guarantees the program account receives a subsidy appropriation of $20 and deposits these funds into the financing account. This $20 expenditure is recorded as an outlay. The financing account also collects the $1 loan origination fee from the borrower. The private lender disburses the $100 loan to the borrower. Thus, the financing account starts with reserves of $21 (from subsidies and fees) and collects interest from the Treasury on the $21. These reserves will be used to make future claim payments for defaults to the private lenders.

Credit Program Accounts. Credit reform requires the appropriation of budget authority for all subsidy costs for direct loan obligations and loan guarantees made beginning in fiscal year 1992. The subsidy appropriations will be recorded in a new program account. For mandatory credit programs, indefinite budget authority is provided to the program account to cover the

demand for all authorized loans. In addition to the subsidy appropriation, an appropriation for the administrative expenses for old and new credit activity will be recorded separately in the credit program account. This treatment recognizes that administrative expenses represent the costs of operating federal loan programs even though they are not included directly in the subsidy estimates.[4]

Subsidy estimates for direct loans are the difference between all the expected government cash outflows, such as loan disbursements and interest expenses, and the net present value of all the expected government cash inflows, such as loan repayments and interest collections. For loan guarantees, subsidies are the net present value of all expected cash flows. Cash flows for loans and guarantees are converted to present value by discounting with expected Treasury interest rates for issues of similar maturities. Box 1 illustrates how the baseline budget authority for subsidy costs in fiscal year 1992 was calculated for the Rural Electrification Administration's 5 percent direct loans.

For discretionary programs, the fiscal year 1992 baseline subsidy budget authority is the estimate of subsidy costs inherent in the enacted loan levels

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4. Under the Federal Credit Reform Act of 1990, the Congressional Budget Office is required to analyze the administrative costs of credit programs and recommend to the Congress any necessary changes in the budgetary treatment of those costs. This analysis will consider the possibility of including administrative costs as part of the subsidy.

BOX 1

Calculation of Subsidy Cost for 5 Percent Direct Loans from the Rural Electrification Administration for One Year's Obligations
(By fiscal year, in millions of dollars)

	1991	1992	1993	.....	2030
Loan Obligations	673				
Loan Disbursements	84	151	168		0
Repayments	0	-5	-13		-2
Net cash flows	84	146	155		-2

Net Present Value (NPV) of all cash flows = 187

Net present value calculation is the sum of the net present values of cash flows associated with each year's disbursements, discounted by the projected Treasury interest rate for loans of the same term for the year of disbursement.

Subsidy Rate = The sum of the NPV + Obligations

= 187 + 673

= 27.8 percent

for 1991, adjusted for inflation. For mandatory programs, subsidy budget authority is the estimate of the annual expected volume of loans. Annual outlays for subsidy costs are estimated by multiplying the subsidy budget authority by the rate at which direct loans and loan guarantees are disbursed.

Tables 1 and 2 show the CBO baseline subsidy estimates for discretionary and mandatory credit programs included in credit reform.[5] Among discretionary loan programs, the Rural Housing Insurance Fund (in the Commerce and Housing Credit function of the federal budget) ranks first with $816 million in subsidy budget authority, which is estimated to support nearly $2.2 billion in direct loans in fiscal year 1992. Because these loans have relatively high delinquency rates and average interest rates of 3 percent, the loans have a 38 percent subsidy rate. For discretionary loan guarantees, the Federal Housing Administration General and Special Risk program (also in the Commerce and Housing Credit function) ranks highest in subsidy budget authority with $314 million estimated for fiscal year 1992. Even though the amount of subsidy budget authority is high, the collection of fees from borrowers results in only a 5 percent subsidy rate, supporting $6.3 billion in loan guarantees in fiscal year 1992.

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5. The Congressional Budget Office is required by law to project the budget baseline in order to provide the Congress with a reference point to compare with policy changes. For entitlement programs, the baseline is whatever spending is anticipated to occur under current law. For discretionary programs, which includes most credit programs, the baseline is the amount of spending that would occur in the next year if the program were maintained at the same inflation-adjusted level as is currently appropriated.

TABLE 1. DISCRETIONARY FEDERAL CREDIT PROGRAMS, BY FUNCTION
(In millions of dollars)

Budget Function and Loan Program	CBO Baseline FY 1992 Obligations	Subsidy Percent	CBO Baseline FY 1992 Subsidy BA
	Direct Loans		
International Affairs			
Public Law 480, Food Aid	605	68.5	414
Export-Import Bank	783	20.6	161
Foreign Military Sales	437	9.5	41
Overseas Private Investment Corporation	40	17.3	7
Private Sector Revolving Fund	15	21.3	3
Emergencies in the Diplomatic Corps and Consulates	1	9.9	a
Energy			
Rural Electrification Administration, Federal Financing Bank	1,587	0.7	11
REA Rural Development Loans	6	34.0	2
Natural Resources			
Asbestos in Schools	33	55.2	18
Bureau of Reclamation	5	48.7	3
Agriculture			
Agricultural Credit Insurance Fund (Disaster Loans)	107	29.9	32
Commerce and Housing Credit			
Rural Housing Insurance Fund	2,159	37.8	816
Business Loan and Investment Fund	75	37.7	28
Transportation			
AMTRAK Corridor Improvement Loans	4	24.9	1

(continued)

TABLE 1. (continued)

Budget Function and Loan Program	CBO Baseline FY 1992 Obligations	Subsidy Percent	CBO Baseline FY 1992 Subsidy BA
	Direct Loans (continued)		
Community and Regional Development			
Disaster Loan Fund (Small Business Administration)	365	30.8	112
Rural Development Insurance Fund	662	15.9	105
Rural Telephone Bank	191	19.9	38
Rural Development Loan Fund	34	61.3	21
Rehabilitation Loan Fund	75	25.7	19
Revolving Fund for Loans (Bureau of Indian Affairs)	9	21.3	2
Education, Training, Employment, and Social Services			
College Housing and Academic Facilities	29	20.9	6
Veterans' Benefits and Services			
Vocational Rehabilitation Fund	2	6.2	a
Education Loan Fund	a	39.3	a
	Loan Guarantees		
International Affairs			
Export-Import Bank	6,621	0.7	44
Housing and Other Credit Guarantee Programs	152	8.8	13
Commerce and Housing Credit			
Federal Housing Administration Fund	6,271	5.0	314
Business Loan Investment Fund	4,222	5.5	233
Rural Housing Insurance Fund	102	16.9	17
Federal Ship Financing Fund, Fishing Vessels (National Oceanic Atmospheric Administration)	108	3.4	4
Community and Regional Development			
Rural Development Insurance Fund	162	5.7	9
Indian Loan Guarantee and Insurance Fund	47	12.3	6
Economic Development Assistance Programs	10	5.5	1

(continued)

TABLE 1. (continued)

Budget Function and Loan Program	CBO Baseline FY 1992 Obligations	Subsidy Percent	CBO Baseline FY 1992 Subsidy BA
	Negative Subsidies		
International Affairs			
Overseas Private Investment Corporation - Guarantees	255	-2.2	-6
Private Sector Revolving Fund - Guarantees	116	-2.2	-3
Commerce and Housing Credit			
Mutual Mortgage Insurance	28,489	-3.1	-894
Ginnie Mae Guarantees (Mortgage-backed securities)	83,200	-0.4	-350

SOURCE: Congressional Budget Office

a. Less than $500,000.

TABLE 2. MANDATORY FEDERAL CREDIT PROGRAMS, BY FUNCTION AMOUNT
(In millions of dollars)

Budget Function and Loan Program	CBO Baseline FY 1992 Obligations	Subsidy Percent	CBO Baseline FY 1992 Subsidy BA
	Direct Loans		
Energy			
Rural Electrification Administration	698	26.7	186
Agriculture			
Agricultural Credit Insurance Fund	446	22.4	100
Veterans' Benefits and Services			
Loan Guarantee Revolving Fund	817	7.5	61
Guaranty and Indemnity Fund	37	1.6	1
	Loan Guarantees		
Agriculture			
Commodity Credit Corporation Export Guarantees	5,575	1.7	97
Agricultural Credit Insurance Fund	614	9.1	56
Education, Training, Employment, and Social Services			
Stafford Student Loans	12,200	24.8	3,025
Health			
Health Professions Graduate Student Loans	305	1.4	4
Veterans' Benefits and Services			
Guaranty Indemnity and Fund	15,283	0.7	100
Loan Guaranty Revolving Fund	27	3.0	1

SOURCE: Congressional Budget Office

Title I of the Omnibus Budget Reconciliation Act of 1990 (OBRA) requires that the Rural Electrification Administration's (REA) direct loans for electric distribution and telephone in the energy function be treated as mandatory. These direct loans rank highest in the mandatory direct loan category because of the low interest rates (5 percent) charged to borrowers. Defaults are essentially negligible in this program. The mandatory guarantee program with the highest estimated subsidy is the Stafford student loan program (in the Education, Training, Employment, and Social Services function), which requires $3 billion in subsidy appropriations for the $12.2 billion in loan guarantees is primarily a result of high defaults in addition to substantial interest subsidies.

Reestimates of the subsidy calculations will be made annually. For the first two years, the discretionary caps will be adjusted if the baseline subsidy estimates change.[6] The Federal Credit Reform Act provides permanent indefinite appropriations to the program account to pay for any increase in subsidy reestimates.

Receipt Accounts For Negative Subsidies. Programs may have negative subsidies if the charges associated with federal direct loans and loan

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6. The Omnibus Reconciliation Act of 1990 provides a complicated system of budgetary controls designed to place effective limits on discretionary spending. Under that control system, "caps" have been enacted to set ceilings on the total discretionary budget authority and outlays. Beginning in fiscal year 1992, the caps are adjusted to include discretionary subsidies.

guarantees are estimated to exceed the costs, excluding administrative expenses. Box 2 illustrates how the baseline subsidy budget authority for fiscal year 1992 was calculated for the Federal Housing Administration's mutual mortgage insurance fund loan guarantees. Since subsidy appropriations will not be required in such cases, to the extent that the Congress wishes to limit programs with negative subsidies, it will have to control these programs in some other manner. One way the Congress might do so is by continuing to set limits on credit activity. Other loan guarantee programs that are currently estimated to have negative subsidies include: the Overseas Private Investment Corporation, the Private Sector Revolving Fund, and the secondary guarantees of the Government National Mortgage Association. CBO estimates that the excess of income over cost (excluding administrative expenses) will total over $1 billion in fiscal year 1992 in these four programs (see Table 1).

For these programs, the negative budget authority and outlays will be transferred from the financing account and recorded in the federal budget as proprietary receipts. Proprietary receipts are receipts from the public of a business nature that are credited to receipt accounts. Since the negative subsidy originates from collections from the public, they are proprietary rather than intragovernmental receipts. Such receipts offset federal outlays rather than add to budget revenues. These receipts will not be available for use by the agencies unless the authority to do so is specifically provided in law.

BOX 2

Calculation of Subsidy Cost for Loan Guarantees from the Federal Housing Administration Through the Mutual Mortgage Insurance Fund for One Year's Disbursements
(By fiscal year, in millions of dollars)

	1992	1993	1994	.....	2021
Loan Commitments	44,110				
Lender Disbursement	28,489	0	0		0
Premiums	-1,113	-138	-132		-0
Claims payments	6	139	399		1
Property Sales	-2	-60	-192		-1
Other	2	16	33		4
Net cash flows	-1,108	-44	109		4

Net Present Value (NPV) of all cash flows = -894

Net present value calculation is the sum of the net present values of cash flows associated with each year's disbursements, discounted by the projected Treasury interest rate for loans of the same term for the year of disbursement.

Subsidy Rate = The sum of the NPV + Disbursements

= -894 + 28,489

= -3.1 percent

Financing Accounts. The FCRA requires that a separate financing account be established for each credit program to track the cash flows associated with new credit activity, including the receipt of subsidies from program accounts, loan disbursements and repayments, and the interest paid to or received from the Treasury. The cash flows of the financing account are to be treated as a means of financing the deficit and excluded from the calculations of the budget deficit. If an agency operates both direct loans and loan guarantees, the activities will be recorded in separate financing accounts.

The financing accounts are intended to maintain a balance between program assets and liabilities. The financing accounts for direct loans will receive subsidies from the program accounts for the subsidy costs of new loans disbursed. The financing accounts will then borrow the nonsubsidized portions of the loans from the Treasury, which will finance this borrowing as it does other expenditures. The loans will then be disbursed to borrowers from the financing accounts. For loans disbursed over several years, the financing accounts will receive obligated subsidy balances from the program accounts and will borrow to cover annual advances to borrowers. The financing accounts will also make interest payments to the Treasury and will receive all future repayments of principal and interest from the borrowers.

The financing accounts for loan guarantees will have a different pattern of balances but will record the same information. The guarantee financing accounts will receive the subsidies from the program accounts for the costs of new guarantees disbursed by private lenders in the year the loans are disbursed. The financing accounts will collect fees and premiums for the guarantees from the borrowers. These collections will result in reserve balances that will collect interest from the Treasury. The reserves should accrue equal to expected outlays on default claims as they occur.

If the subsidy calculations are accurate, the financing accounts will have just enough financial resources to meet their liabilities. If the subsidies are inaccurate, however, then the financing accounts will record shortfalls or surpluses. Shortfalls will require a budgetary transfer. For example, if defaults are greater than expected and shortfalls occur, permanent indefinite budget authority will be available to the program account to make payments to the financing account equal to the shortfall. In turn, if revised calculations indicate that the financing account has assets greater than claims on the account (that is, if the cumulative subsidies were overstated) the financing account will make payments to receipt accounts to refund the overage.

There is an important reason for treating the nonsubsidized cash flows associated with new direct loans and guarantees as a means of financing. Only

the subsidies represent the net costs to the government. These costs should be the focus for decisionmaking and analysis. Nonsubsidized cash flows are not relevant for measuring federal costs of providing loan assistance. The aim of credit reform, which is to focus on costs rather than on cash flows, would not be served if the nonsubsidized cash flows were included in the budget totals.

Liquidating Accounts. Credit reform is prospective. It only changes the treatment of new activity. All cash flows resulting from direct loans and loan guarantees prior to October 1, 1991, will be recorded in liquidating accounts.

Any activity in the liquidating accounts will be treated as mandatory, even if spending in the old credit account was discretionary. This treatment is because any new activity in the liquidating account flows from obligations and commitments existing before credit reform. Budget authority and outlays for the liquidating accounts will continue to be included in budget totals. The liquidating accounts will record zero budget authority if repayments of old loans or annual fees collected exceed the outlays of the accounts. Periodically, the liquidating accounts will transfer any excess balances held in the accounts to the general fund of the Treasury. Because these transfers are considered intragovernmental, they will not affect the budget totals. The FCRA

authorizes these transfers to occur to the extent that liquidating balances are "in excess of current needs."

For accounts with no new credit activity beyond fiscal year 1991, the liquidating accounts will also record the administrative expenses associated with the old credit activity. According to the FCRA, all administrative expenses are to be considered discretionary and subject to annual appropriations even if they are part of mandatory liquidating accounts.

Noncredit Accounts. In the past, understanding the costs in credit programs was made more difficult in some cases because of the commingling of credit and noncredit activity in the same account. For example, the Rural Housing Insurance Fund loan program account included over $200 million per year in rental assistance grants. Under credit reform, noncredit accounts have been established to record grant programs, insurance programs, and other noncredit activity that had been funded previously in combined credit accounts.

Budgetary Control

Credit reform is intended to overcome the cost measurement and control deficiencies of current budgetary treatment for credit programs. For discretionary programs, no new federal credit can be extended in the absence

of an appropriation of budget authority to cover the subsidy costs of each federal credit transaction. Credit reform will focus budgetary attention and control on the subsidies provided through federal credit assistance and will recognize these costs in the budget at the time the credit assistance is extended. This information on costs, together with the requirement of budget authority before loans are obligated or committed, will increase the ability of the Congress to control the costs of credit programs.

Although credit reform may improve the Congress's ability to control spending associated with discretionary programs, little will change for credit entitlement or mandatory programs, such as the Veterans Administration's loan guarantees or guaranteed student loans. Loan volume will continue to be controlled through eligibility criteria. Even in these cases, however, the budget will record the subsidy costs for these credit programs when the loans are disbursed and, therefore, when the subsidy occurs.

THE EFFECT OF CREDIT REFORM ON THE CBO BASELINE

Credit reform focuses on the costs of credit programs or subsidies. The effect of credit reform on the CBO baseline is small in aggregate. In fact, as illustrated below, total outlays increase by a modest $2 billion in fiscal year 1992.

1992 CBO Baseline Projections	Outlays (In billions of dollars)
Cash-Basis Accounting	
Cash flows associated with credit activity	13
Administrative expenses	1
Noncredit accounts	20
Subtotal: Budget Outlays	34
Credit Reform Accounting:	
Credit program accounts/ subsidies	4
Administrative expenses	1
Receipt accounts (negative subsidies)	-1
Noncredit accounts	20
Liquidating accounts	12
Subtotal: Budget outlays	36
Total Difference	2

The increase in outlays in the CBO baseline is primarily a result of the accounting requirements of credit reform to record subsidy outlays for guarantee commitments when the private lender disburses the loan. Before credit reform, neither budget authority nor outlays was recorded until a default occurred. In addition, the fees the federal government collects for guarantees are no longer recorded in the budget totals but recorded in the financing accounts. [7]

7. For more details on the effects of credit reform on the baseline see, Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1992-1996* (January 1991).

CONCLUSION

Credit reform identifies and recognizes the two essential elements inherent in federal credit activity: 1) the subsidy or cost to the federal government, and 2) the costless nonsubsidized cash flows. Credit reform establishes a mechanism for the Congress and the President to effectively control the subsidies or costs at the time that they are controllable--when the loan is extended or the guarantee is committed. In addition, credit reform accounting places credit and noncredit programs on equal footing and eliminates the bias in favor of loan guarantees and against direct loans.

APPENDIX

While budget authority for subsidy costs will henceforth be used to control discretionary credit programs, the volume of loan obligations and guarantee commitments that results from the baseline estimates of subsidy costs will remain of interest to the Congress. Baseline budget authority can be translated into projected loan levels by using the estimates of subsidy percentages. For example, if budget authority of $100 were provided for a direct loan program with a 20 percent subsidy rate, the program will be able to obligate $500 in loans.

The loan levels enacted for fiscal year 1991 and projected for fiscal year 1992 discretionary and mandatory programs are shown in Table A 1. The 1992 loan levels, supported by the projected 1992 subsidy budget authority, were calculated by dividing the subsidy budget authority by the subsidy rate. Loan levels for mandatory programs are equal to the estimate of borrower demand under law.

For most discretionary direct loan programs, the difference between the 1991 enacted loan level and the 1992 projected loan level that is supported by the subsidy budget authority is mostly the result of inflation. One

TABLE A1. CBO ESTIMATES OF OBLIGATIONS AND COMMITMENTS (In billions of dollars)

Budget Function	1991	1992
Discretionary Direct Loans		
International Affairs	1.7	1.8
Energy	0.8	1.6
Natural Resources and Environment	a	a
Agriculture	0.1	0.1
Commerce and Housing Credit	2.1	2.2
Transportation	a	a
Community and Regional Development	1.2	1.3
Education, Training, Employment, and Social Services	a	a
Income Security	0.1	a
Total	6.2	7.1
Discretionary Loan Guarantees		
International Affairs	7.7	7.3
Energy	0.2	0.2
Agriculture	1.3	1.4
Commerce and Housing Credit	54.3	54.7
Community and Regional Development	0.4	0.2
Total	63.9	63.8
Mandatory Direct Loans		
Energy	1.0	0.7
Agriculture	7.2	8.3
Commerce and Housing Credit	2.8	a
Income Security	a	a
Veterans' Benefits and Services	0.9	0.6
Total	11.9	9.6

(continued)

TABLE A1. (continued)

Budget Function	1991	1992
Mandatory Loan Guarantees		
Energy	0.4	a
Agriculture (includes FAC guarantees)	6.1	6.8
Commerce and Housing Credit	0.1	0.1
Education, Training, Employment, and Social Services	12.5	12.2
Income Security	0.3	0.3
Veterans' Benefits and Services	16.0	16.0
Total	35.3	35.4

SOURCE: Congressional Budget Office

a. Less than $50 million.

exception is the Rural Electrification Administration's Federal Financing Bank loans in the Energy function of the federal budget. Table A 1 shows loans in the Energy function doubling in 1992. Because the Congressional Budget Office forecasts decreasing interest rates, the subsidy rate for these loans also decreases and, therefore, the baseline subsidy budget authority will support a higher volume of loans.

The differences that exist in the mandatory direct loan category in Table A 1 are, in part, a result of excluding certain credit programs from credit reform (for example, the Tennessee Valley Authority, Commodity Credit Corporation, Credit Union Share Insurance fund, and Pension Benefit Guaranty Corporation). In addition, the 1991 direct loan levels (in the Commerce and Housing Credit function of the budget) include $2.8 billion, representing advances made by the Resolution Trust Corporation to failing thrifts with no new advances estimated for fiscal year 1992. Agriculture mandatory direct loans increase in 1992 because Title I of the Omnibus Budget Reconciliation Act requires that 5 percent loans from the REA and the nondisaster direct loans (formerly discretionary) from the Agricultural Credit Insurance Fund be treated as mandatory.